No. 82-500

# In the Supreme Court

OF THE

# United States

OCTOBER TERM, 1982

THE SOUTHLAND CORPORATION, et al.,
*Appellants,*

vs.

RICHARD D. KEATING, et al.,
*Appellees.*

**ON APPEAL FROM THE SUPREME COURT OF CALIFORNIA**

## MOTION TO DISMISS


*Of Counsel:*

STARK, STEWART, WELLS & ROBINSON
Oakland, CA

BROWN & FINNEY
San Francisco, CA

JOHN F. WELLS
COUNSEL OF RECORD
LISE A. PEARLMAN
FONDA KARELITZ
Fidelity Plaza, 14th Floor
180 Grand Avenue
Oakland, CA 94612
Telephone: (415) 834-2200

ROBERT M. BROWN
Suite 1220
1 Maritime Plaza
San Francisco, CA 94111
Telephone: (415) 421-0400

*Attorneys for Appellees Richard D. Keating, et al.*


November 1982


BOWNE OF SAN FRANCISCO, INC. • 180 NINTH ST. • S.F., CA 94103 • (415) 864-8500

## QUESTIONS PRESENTED

Pursuant to Rule 16 of this Court, the appellees move to dismiss the appeal now pending before this Court for the following reasons:

1. As to the class arbitration issue, none of the essential requisites to this Court's jurisdiction are present. The decision which Southland attempts to appeal from is not a final judgment on this issue. Nor was any federal question properly raised in the courts below. Even if those two jurisdictional prerequisites were present, no appeal would lie but only a petition for certiorari, which should be denied for lack of a substantial federal question.

2. The second issue likewise presents no substantial federal question. This issue is whether a California statutory scheme concerning arbitration is preempted by the Federal Arbitration Act (9 U.S.C. § 1 *et seq.*). The California statutory scheme contains both a modern arbitration statute (Cal. Code Civ. Proc. § 1280 *et seq.*) substantially identical to the federal act and an exception identical to and modeled after a federal exception to arbitration. The decision below is in accordance with other state and federal decisions. No substantial federal question is involved.

## TABLE OF CONTENTS


| | Page |
|---|---|
| Questions presented | i |
| Statement of the case | 1 |
| Southland has failed to show that this court has jurisdiction | 4 |
| A. There is no appellate jurisdiction on the class arbitration issue | 5 |
| 1. The question of whether the Federal Arbitration Act bars a class arbitration was not raised below | 5 |
| 2. There is no final judgment before this Court on the issue of class arbitration | 6 |
| 3. Assuming this Court would otherwise have jurisdiction, the class arbitration issue is properly one for certiorari rather than appeal | 8 |
| B. Southland has failed to demonstrate that there are any substantial federal issues | 8 |
| 1. The Federal Arbitration Act does not displace local rules of procedure | 10 |
| 2. The preemption issue does not present a substantial Federal question | 14 |
| Conclusion | 26 |

## TABLE OF AUTHORITIES CITED

### Cases


| | Page |
|---|---|
| Addington v. Texas, 441 U.S. 418 (1979) | 8 |
| A. & E. Plastik Pak Co. v. Monsanto Company, 396 F.2d 710 (9th Cir. 1968) | 18 |
| Aimcee Wholesale Corp. v. Tomar Products Inc., 21 N.Y.2d 621, 237 N.E.2d 223 (1968) | 18 |
| Allegaert v. Perot, 548 F.2d 432 (2d Cir.) cert. denied, 432 U.S. 910 (1977) | 17 |
| Allison v. Medicab International, Inc., 92 Wash.2d 199, 597 P.2d 380 (1979) | 16, 19, 20 |
| American Airlines, Inc. v. Louisville & Jefferson C.A.B., 269 F.2d 811 (6th Cir. 1959) | 21, 22 |
| American Safety Equipment Corp. v. J. P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968) | 17 |
| Applied Digital Technology, Inc. v. Continental Casualty Co., 576 F.2d 116 (7th Cir. 1978) | 18 |
| Ayres v. Merrill Lynch, Pierce, Fenner & Smith, 538 F.2d 532 (3d Cir. 1976) | 17 |
| Bache Halsey Stuart Shields, Inc. v. Moebius, 531 F. Supp. 75 (E.D. Wisc. 1982) | 16 |
| Barron v. Tastee Freez Intern., Inc., 482 F.Supp. 1213 (E.D. Wisc. 1980) | 16 |
| Bernhardt v. Polygraphic Co., 350 U.S. 198 (1956) | 16, 19 |
| Boynton v. Carswell, 238 Ga. 417, 233 S.E.2d 185 (1977) | 13 |
| Briskin v. Glickman, 267 F.Supp. 600 (S.D.N.Y. 1967) | 12 |
| Callaway v. Carswell, 240 Ga. 579, 242 S.E.2d 103 (1978) | 13 |
| Cardinale v. Louisiana, 394 U.S. 437 (1969) | 5 |
| Cox Broadcasting Corp. v. Cohn, 420 U.S. 469 (1975) | 6, 7 |
| Deposit Guaranty National Bank v. Roper, 445 U.S. 326 (1980) | 12 |
| Dickstein v. DuPont, 443 F.2d 783 (1st Cir. 1971) | 23 |

## Table of Authorities Cited

### Cases


| | Page |
|---|---|
| Duplan Corp., etc. v. W.B. Davis Hosiery Mills, 442 F.Supp. 86 (S.D.N.Y. 1977) | 22 |
| Durst v. Abrash, 22 A.D.2d 39, 253 N.Y.S.2d 351 (1964) | 18 |
| Fidelity Federal Savings & Loan Assn. v. de la Cuesta, ..... U.S. ....., 102 S.Ct. 3014 (1982) | 21 |
| Flynt v. Ohio, 451 U.S. 619 (1981) | 7 |
| General Trading Co. v. State Tax Comm., 322 U.S. 335 (1944) | 16 |
| Hamilton v. Home Ins. Co., 137 U.S. 370 (1890) | 10 |
| Harris v. Shearson Hayden Stone, Inc., 82 A.D.2d 87, 441 N.Y.S.2d 70 (1981), aff'd mem., 56 N.Y.2d 627, 450 N.Y.S.2d 482 (1982) | 13 |
| Kiehne v. Purdy, ..... Minn. ....., 309 N.W.2d 60 (1981) | 15, 18 |
| Kristiansen v. John Mullins & Sons, Inc., 59 F.R.D. 99, (E.D.N.Y. 1973) | 12 |
| Kulko v. California Superior Court, 436 U.S. 84, 90 (1978) | 8 |
| LaSala v. American Sav. & Loan Assn., 5 Cal.3d 864, 877 (1971) | 13 |
| Lathrop v. Donohue, 367 U.S. 820 (1961) | 8 |
| Lee v. Ply Gem Industries, Inc., 593 F.2d 1266 (D.C. Cir.), cert. denied 441 U.S. 967 (1979) | 18 |
| Main v. Merrill Lynch, Pierce, Fenner & Smith, 67 Cal. App.3d 19 (1977) | 12 |
| Mansbach v. Prescott Ball & Turben, 598 F.2d 1017 (6th Cir. 1979) | 17 |
| Merrill Lynch, Pierce, Fenner & Smith Inc. v. Melamed, 405 So. 2d 790 (Fla. [Dist. Ct. App.] 1981) | 19 |
| Merrill Lynch, Pierce, Fenner & Smith v. Moore, 590 F.2d 823 (10th Cir. 1978) | 17 |

## Table of Authorities Cited

### Cases

Page

Merrill Lynch, Pierce, Fenner & Smith v. Ware, 414 U.S. 117 (1973) ..... 15, 16, 21, 22, 23, 24, 25

Middle East Transcontinental, Inc. v. Onion Crock, Inc., 144 Mich.App. 57, 318 N.W.2d 604 (1982) ..... 19

Muh v. Newburger, Loeb & Co., 540 F.2d 970 (9th Cir. 1976) ..... 16, 23, 24

Pinkis v. Network Cinema Corporation, 9 Wash.App. 337, 512 P.2d 751 (1973) ..... 16

Prima Paint v. Flood & Conklin, 388 U.S. 395 (1967) ..... 11, 12, 17

Ray v. Atlantic Richfield Co., 435 U.S. 151 (1978) ..... 20

Republic Natural Gas Co. v. Oklahoma, 334 U.S. 62 (1948) ..... 5

R.J. Palmer Construction Co. v. Wichita Band Instrument Co., 7 Kan.App. 363, 642 P.2d 127 (1982) ..... 18, 19

Robert Lawrence Co. v. Devonshire Fabrics, 271 F.2d 402 (2d Cir. 1959) ..... 11, 12, 23

Sandefer v. Reynolds Securities Inc., 618 P.2d 690 (Colo. App. 1980) ..... 15, 18

Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974) ..... 17

Sibley v. Tandy Corp., 543 F.2d 540 (5th Cir. 1976) ..... 17

State Ex. Rel. Geil v. Corcoran, 623 S.W.2d 557 (Mo. App. 1981) ..... 15, 20

Stevenson v. Com. of Pennsylvania, Dept. of Revenue, 413 A.2d 667 (Pa. 1980) ..... 13

Stokes v. Merrill Lynch, Pierce, Fenner & Smith, 523 F.2d 433 (6th Cir. 1975) ..... 23

Supak & Sons Mfg. Co. v. Pervel Industries, Inc., 593 F.2d 135 (4th Cir. 1979) ..... 22

Tenney Engineering, Inc. v. United Electrical Radio & Machine Workers, 207 F.2d 450 (3d Cir. 1953) ..... 23

## Table of Authorities Cited

### Cases


| | Page |
|---|---|
| The Alanten, 252 U.S. 313 (1920) | 10 |
| United Nuclear Corp. v. General Atomic Co., 93 N.M. 105, 597 P.2d 290, cert. denied, 444 U.S. 911 (1979) | 18 |
| Vasquez v. Superior Court, 4 Cal.3d 800 (1971) | 13 |
| Vernon v. Drexel Burnham & Co., 52 Cal.App.3d 706 (1975) | 12 |
| Vigo Steamship Corp. v. Marship Corp., 26 N.Y.2d 165, 309 N.Y.S.2d 165, cert. denied, 400 U.S. 819 (1970) | 12 |
| Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, 558 F.2d 831 (7th Cir. 1977) | 17 |
| Wilko v. Swan, 346 U.S. 427 (1953) | 15, 16, 17, 19, 24 |
| Wineland v. Marketex Intern. Inc., 28 Wash.App. 830, 627 P.2d 967 (1981) | 20 |
| Zahn v. International Paper Company, 414 U.S. 291 (1973) | 13 |


### Constitution


| | |
|---|---|
| United States Constitution, Article III | 10 |


### Rules


| | |
|---|---|
| Federal Rules of Civil Procedure: | |
| Rule 42(a) | 10 |
| Rule 81(a)(3) | 10 |


### Statutes


| | |
|---|---|
| California Code of Civil Procedure: | |
| Section 1280 et seq. | i |
| Section 1294 | 3 |
| California Corporation Code: | |
| Section 31500 et seq. | 1 |
| Section 31512 | 4, 15, 22, 24 |

TABLE OF AUTHORITIES CITED

STATUTES


| | Page |
|---|---|
| Federal Arbitration Act, 9 U.S.C.: | |
| Section 1 | 17, 23 |
| Section 1 et seq. | i |
| Labor Code, Section 229 | 22, 24 |
| U.C.C. Section 2-707(2)(b) | 22 |
| United States Code: | |
| Title 15 Section 77n | 15 |
| Section 78f | 22 |
| Title 28 Section 1257 | 5, 6 |
| Section 1257(2) | 8 |


**Other Authorities**


| | |
|---|---|
| Cohen and Dayton, *The New Federal Arbitration Law*, 12 Va.L.Rev. 265, 275-276 (1926) | 10, 11 |
| Committee on Commerce, Trade and Commercial Law, *The United States Arbitration Act and Its Application*, 11 A.B.A.J. 153, 154-155 (1925) | 11 |
| Consumer Protection Act. 28 Wash.App. at ...., 627 P. 2d at 970 | 20 |
| Contracts of adhesion, e.g., Iowa Code Ann. § 697A.1 (West Supp. 1982) | 19 |
| H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924) | 11 |
| Tex. Rev. Civ. Stat. Ann. art. 224 (Vernon Supp. 1981) | 18, 19 |
| torts, e.g., Ark. Stat. Ann. § 34-511 (Bobbs-Merrill Supp. 1981) | 19 |
| Uninsured motorists, doctors and lawyers, e.g., S.C. Code § 15-48-10 (Lawyer Co-op Supp. 1981) | 19 |
| 1983-85 Pub. L. No. 97-247 (1982) | 18 |

No. 82-500

# In the Supreme Court

OF THE

# United States

---

OCTOBER TERM, 1982

---

THE SOUTHLAND CORPORATION, et al.,
*Appellants,*

VS.

RICHARD D. KEATING, et al.,
*Appellees.*

---

**ON APPEAL FROM THE SUPREME COURT OF CALIFORNIA**

---

**MOTION TO DISMISS**

---

## STATEMENT OF THE CASE

This case is before the Court solely on the basis of a California decision on the pleadings. Because of the undeveloped posture of the case, the allegations in the plaintiffs-appellees' ("plaintiffs") complaints were deemed true for purposes of decision by the California Supreme Court.

Those allegations are that the plaintiffs are either past or present franchisees of the convenience food stores commonly known as "7-Eleven" Stores. There are approximately 800 such franchise stores in the state of California. The Southland Corporation ("Southland") is the franchisor for each of these stores. In selling the franchises, Southland employs a standard form prospectus which purports to make the disclosures required by the California Franchise Investment Law[1] and a standard form of franchise agreement. After a franchise is sold, the operation of individual 7-Eleven stores is governed by a centralized bookkeeping system created and maintained by Southland.

The plaintiffs all entered into nearly identical franchise agreements with Southland. The lengthy printed contracts were offered on a take-it-or-leave-it basis and, as the California Supreme Court found, were adhesive in nature. Each of these contracts contained the same arbitration clause requiring that all disputes be subject to arbitration before the American Arbitration Association.

After becoming franchisees, the individual plaintiffs became convinced that Southland was guilty of various acts of wrongdoing. The eight coordinated lawsuits which are now before this Court were each filed at different times. The earliest action was filed by Edward and Betty Gouveia in the Superior Court for Santa Clara County in 1975; Thomas and Wanda Lee Sampson and Patrick and Cathy Cheng filed their separate actions in 1976; Phillip and Joan Newell filed their action in 1977. The case of *Garza v.*

---

[1]California Corporations Code, sections 31500 et seq.

*Southland,* which was later dismissed pursuant to a settlement, was filed in Alameda County in 1976. In none of these actions did Southland move to compel arbitration. Thereafter, Richard D. and Darla Keating filed a class action in May 1977. A similar class action was filed by Harry M. Battersby in December 1977.

Because of the similarity of the individual and class actions, the California Judicial Council ordered that all the actions pending in superior courts of several counties be controlled by one state court as a coordinated proceeding. Other pending cases against Southland were coordinated before the same court. (*Coy v. Southland* and *Southland v. Scovis.*) As part of that coordinated proceeding, the plaintiffs amended their complaints to be more uniform.

In all the cases, the plaintiffs alleged that Southland violated the California Franchise Investment Law and sought declaratory relief establishing the invalidity of the arbitration clause. Except in the *Coy* and *Scovis* cases, which are limited to the statutory claims, the plaintiffs also alleged common law claims of breach of contract, breach of fiduciary duty, violation of the usury law and fraudulent and negligent misrepresentation.

The principal allegations of classwide misconduct are (1) that Southland systematically defrauded its franchisees by making inadequate or misleading disclosures in connection with the sale of franchises; (2) that it failed to provide accurate information on the expected overall performance of 7-Eleven stores; and (3) that it systematically charged the franchisees interest on invoices paid by the franchisor to suppliers for periods of time preceding actual payment.

For two years, when the only pending actions were those on behalf of a few scattered individuals, Southland did not move to arbitrate those cases even though in some of the actions it alleged arbitration as an affirmative defense. Instead, it took full advantage of the judicial process by cross-complaining in three of the actions and by engaging

in extensive discovery. For example, in *Gouveia,* the plaintiffs were deposed for five days. One of the plaintiffs in the *Garza* action was deposed for five days and the other for two days. Again, in the *Sampson* action, there was a three-day deposition of a witness. In *Cheng,* the named plaintiff's deposition was begun although not concluded. Only when the class action case of *Keating* was filed did Southland assert its right to arbitrate the issues in each of the pending actions. In Southland's view, the litigation did not really begin until the filing of *Keating,* the first class action. (Jurisdictional Statement ("J.S.") 3.)

Pursuant to Southland's motion to arbitrate, the actions were stayed in the trial court before class discovery had commenced and before a motion for certification could be made. The trial court ordered all common law issues arbitrated on an individual basis, refusing to entertain a prior motion for class certification. The plaintiffs sought a writ of mandate from the California Court of Appeal to reverse this part of the trial court's order. The order to arbitrate excluded any claims arising under the Franchise Investment Law which the trial court ruled were triable only in a judicial forum. Southland then appealed that ruling pursuant to the California arbitration statute (Cal. Code Civ. Proc. § 1294). By stipulation, the appeal and writ were consolidated for hearing before the California appellate courts.

The matters before the California Supreme Court were not the broad, sweeping issues which Southland portrays. Rather, as to the class claims, the issue was whether, under the narrow facts of the case, the competing policies underlying arbitration and class action, both of which are favored in California, may be reconciled in a manner which preserves the viability of each procedure. The court was fully aware that one solution was to hold that arbitration agreements contained in adhesion contracts may not operate to stay class actions otherwise properly maintainable in court. The court did not take this approach because, as it stated,

"the statutes and public policy supportive of arbitration require, however, that this result be avoided if means are available to give expression to the basic arbitration commitment of the parties." (J.S.App., 26a.) Instead, it approved the class arbitration as accommodating and preserving each procedure.

On the issue of whether the Franchise Investment Law claims were arbitrable, the court made a two-step analysis of the effect of Corporations Code section 31512. First, it determined that the California Legislature intended that the right of a franchise investor to a judicial forum could not be waived by an arbitration clause. The court then turned to the issue of preemption. Noting that California law and federal law are the same with respect to favoring arbitration, the court found that the Federal Arbitration Act was not intended to prevent or invalidate statutes, such as section 31512, based on a specific legislative policy to protect a particular class of litigants. (J.S.App. 17a-18a.)

## SOUTHLAND HAS FAILED TO SHOW THAT THIS COURT HAS JURISDICTION

This case concerns a group of California franchisees affected by a preliminary decision of the state supreme court that its procedural law permits class arbitration of common law claims and that its Legislature was entitled to designate a judicial forum for statutory claims under the Franchise Investment Law. No substantial federal question is raised here. In today's world "Mom and Pop" grocery stores have in large part given way to franchises. The corner grocery—locally run and catering to local customers—is deemed to be involved in interstate commerce because it bears a federally registered trademark ("7-Eleven") and the franchisor with whom it has to deal is located in another state. Nonetheless, the franchisees' substantive claims in this litigation are governed entirely by the statutory and common law of the state of California where the franchises are operated.

To invoke this Court's jurisdiction, Southland must affirmatively demonstrate that it has met the threshold requirements of 28 U.S.C. § 1257. *Republic Natural Gas Co. v. Oklahoma,* 334 U.S. 62, 70-71 (1948). It has failed to do so. As to the issue of class arbitration it has not shown (1) that there is a final judgment; (2) that the federal law was drawn into question below; or (3) that a federal question is presented. As to the issue of whether the Federal Arbitration Act preempts state protective legislation paralleling federal protective legislation, the decision below is clearly correct, and presents no substantial federal question.

**A. There Is No Appellate Jurisdiction on the Class Arbitration Issue**

**1. The question of whether the Federal Arbitration Act bars a class arbitration was not raised below**

This Court has consistently refused to hear cases where the federal question is first raised by a party when seeking review in this tribunal. *Cardinale v. Louisiana,* 394 U.S. 437, 438 (1969). In fact, the Court is without "jurisdiction unless a federal question was raised and decided in the state court below." 394 U.S. at 438.

In its jurisdictional statement, Southland asks this Court to consider the question of whether "arbitration under the Federal Arbitration Act is unlawfully impaired" by an order requiring the trial court merely to consider whether class arbitration may be appropriate in this case. The thrust of Southland's argument is that because the Federal Arbitration Act establishes a strong federal policy in favor of arbitration, states cannot apply local procedures which might impair the federal policy.

**Before the California Supreme Court, however, Southland did not argue that the federal act barred the class procedure. Rather, Southland contended that class arbitration was precluded by general policies in favor of arbitra-**

tion, citing California precedent supposedly to that effect, and by the absence of *state* legislation authorizing a class action within the arbitration process. The California Supreme Court, was thus faced only with a conflict between *state* policies in favor of arbitration and *state* policies in favor of class actions. (J.S.App. 23a-30a.)[2] As the question now presented was neither raised nor decided below, Southland has not met this threshold jurisdictional requirement of 28 U.S.C. section 1257.

**2. There is no final judgment before this Court on the issue of class arbitration**

The California Supreme Court decision which Southland attempts to appeal is not a final judgment. As the court itself stated: "We assume, for purposes of this analysis, that *Keating* and *Battersby* would be maintainable as class actions under established principles, but we intimate no opinion as to whether that is, in fact, the case. That will be an issue for the trial court upon remand." (J.S.App.24a, n. 17.)

In *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469 (1975), this Court set forth four exceptions to the traditional final judgment rule, based on a practical application of that rule

---

[2]Southland's petition to the California Supreme Court phrased the question as "[w]hether a court may enter an order compelling a private commercial arbitration governed by the Federal Arbitration Act and rules of the American Arbitration Association to proceed as a class action even though the terms of the parties' arbitration agreement do not provide for such a procedure." (South. Pet. for Hearing, p. 3.) Nevertheless, Southland did not argue below that the Federal Arbitration Act, as opposed to the California statute, barred the class action and, in fact, it relied on California authorities and discussed federal and foreign state law only for their persuasive value. As a consequence, both the majority and the dissent discussed this issue in terms of state law. The dissenting justices disagreed with the majority on the policy question and concluded that there was no contractual or California statutory basis for allowing class arbitration. (J.S. App. 37a-45a.)

to state court decisions which anticipate further proceedings in lower state courts. The only exception possibly relevant here is the fourth and last category directed to state decisions which "seriously erode" federal policy. In these instances, the federal issue has been finally decided, and reversal on the federal issue "will be preclusive of any further litigation on the relevant cause of action rather than merely controlling the nature and character of . . . the state proceedings still to come." 420 U.S. at 483. Review, however, may be granted only if, in addition, the state decision might "seriously erode" federal policy. 420 U.S. at 483.

The preliminary decision by the California Supreme Court that the trial court should consider whether there should be a class arbitration does not meet these criteria. First, a reversal by this Court would not "be preclusive of any further litigation on the cause of action" because the decision merely sanctions a procedure in the continuing litigation. Thus, it is expressly outside this exception.[3] Second, the exception is to be narrowly construed. The recent case of *Flynt v. Ohio,* 451 U.S. 619 (1981) noted that this exception must be limited to cases which seriously erode federal policy or else it would swallow the rule and every federal issue decided on a state interlocutory appeal would qualify for immediate review. Because the California decision concerns a matter of state court procedure, this criterion also is not met.

Accordingly, there can be no review at this time of the class action issue because of the lack of a final judgment.

---

[3]In addition, although this Court's reversal would preclude further consideration of a class arbitration, such reversal would not eliminate the possibility of further, allegedly federal, issues arising, such as in connection with consolidation of individual arbitration proceedings. Southland asserts that the courts' authority to order consolidation is unsettled. (J.S. 19, n. 29.)

### 3. Assuming this Court would otherwise have jurisdiction, the class arbitration issue is properly one for certiorari rather than appeal

Southland erroneously contends that the class arbitration issue falls within this Court's appellate jurisdiction under 28 U.S.C. § 1257(2). (J.S. 2.) That section, however, authorizes an appeal only where a state statute was challenged below as repugnant to a federal law or the Constitution and found valid. Southland has not met this requirement.

In the case below, Southland did not challenge the validity of a state statute. Nor does it here. It does not frame the issue as a challenge to the validity of any particular state act which is "legislative in character," *Lathrop v. Donohue*, 367 U.S. 820, 824 (1961), but rather as a question of whether the lower court's decision theoretically impairs a federally protected right. (J.S. i.) When a party makes no challenge to the validity of a statute, but instead challenges a court's decision to take certain judicial action, an appeal does not lie and review can be premised only on this Court's discretionary jurisdiction. *Kulko v. California Superior Court*, 436 U.S. 84, 90 (1978). Thus, even if Southland had drawn the federal issue into question below and if there were a final judgment—and such have not been shown—Southland would at best be entitled to petition this Court for certiorari. *Addington v. Texas*, 441 U.S. 418, 422-423 (1979).

## B. Southland Has Failed to Demonstrate That There Are Any Substantial Federal Issues

**Both of the federal questions which Southland has attempted to frame are based on an overly broad reading of the Federal Arbitration Act. Thus, Southland argues that the California court's approval of the concept of class-wide arbitration as a matter of California procedural law will somehow impair the application of the Federal Arbitration Act in federal courts or other state courts. As to**

the California Legislature's intention to require a judicial forum for resolution of claims under the Franchise Investment Law, Southland makes the sweeping assertion that "state-created 'exceptions' " would fly in the face of the Federal Arbitration Act and "violate the intent of Congress." (J.S. 28.) Southland is wrong on both counts. The California court's decision does not in any way undermine the Federal Arbitration Act or evince hostility toward arbitration as a means of dispute resolution.

California, like most states, has a modern arbitration act which it vigorously enforces.[4] It also applies the substantive provisions of the Federal Arbitration Act in cases involving interstate commerce. But the act does not govern the procedure to be followed by the state. The issue as to whether the arbitration can be handled on a class action basis is purely a question of state law. Thus, on this issue, the California Supreme Court undertook to reconcile potentially conflicting state policies favoring arbitration and favoring class actions. The court concluded that state policy favoring arbitration did not prevent use of the procedural device of a class action.

The court faced a different issue on the statutory claims. There, it had to reconcile the substantive provisions of the Federal Arbitration Act with the narrow exception to arbitrability embodied in the antiwaiver provision of California's Franchise Investment Law. The court concluded that the Federal Arbitration Act did not preclude the state legislature from specifying a judicial forum for enforcement of its Franchise Investment Law.

---

[4]Since 1927, the California courts and Legislature "have 'consistently reflected a friendly policy toward the arbitration process.' That policy was expanded and clarified in the current arbitration statute which was adopted in 1961 and it continues to be the policy of this state." (J.S. App. 15a-16a (citations omitted).)

### 1. The Federal Arbitration Act does not displace local rules of procedure

The Federal Arbitration Act was intended to provide a procedure limited to the federal courts. Neither Congress nor this Court has ever determined that the scope of the Act should extend into the state courts so as to override their procedures, including class actions. Indeed, in the hearing before the California Supreme Court, Southland itself contended that under the *Erie* doctrine, the California District Court of Appeal had erred by applying the Federal Rules of Civil Procedure, Rules 81(a)(3) and 42(a), to a matter governed by California procedure.[5]

Prior to 1925, the federal courts, reflecting a traditional hostility toward arbitration agreements, generally refused to hold arbitration clauses specifically enforceable. *The Alanten,* 252 U.S. 313 (1920); *Hamilton v. Home Ins. Co.,* 137 U.S. 370 (1890). Even if the federal courts were inclined to enforce the clauses, there was no procedure by which they could do so. Cohen and Dayton, *The New Federal Arbitration Law,* 12 Va.L.Rev. 265, 275-276 (1926). The Federal Arbitration Act was drafted by the American Bar Association's Committee on Commerce, Trade and Commercial Law to remedy this situation. It was enacted by Congress in 1925 pursuant to its powers under the Commerce Clause, Admiralty and Article III of the Constitution.

---

[5]As Southland stated, "[t]he Federal Rules of Civil Procedure are not applicable here. Under the *Erie* doctrine, state courts normally apply their own procedural rules in litigation involving a federal substantive right, provided such application does not impair the federal right. And under California law . . . there is no basis—statutory or otherwise—for compelling class arbitrations." (South. Pet. for Hearing, pp. 24-25.) Southland thus acknowledged that local procedure controlled and that the question was one of the state court reconciling state policies favoring both arbitration and class actions. See. pp 5-6, *supra.*

A chief author of the Act, Julius Cohen, wrote at the time,

> [T]he statute as drawn establishes a *procedure in the Federal courts* for the enforcement of certain arbitration agreements. It is *no infringement* upon the *right of each state* to decide for itself what contracts shall or shall not exist under its laws. . . . [W]hether or not an arbitration agreement is to be enforced is a question of the law of procedure and is determined by the law of the jurisdiction wherein the remedy is sought. Cohen & Dayton, *The New Federal Arbitration Law*, 12 Va.L.Rev., at 275-276 (italics supplied).

The drafting committee itself noted that the "statute providing for the enforcement of arbitration agreements does relate solely to *procedure of the Federal courts*. It is no infringement upon the right of each state to decide for itself what contract shall or shall not exist." Committee on Commerce, Trade and Commercial Law, *The United States Arbitration Act and Its Application*, 11 A.B.A.J. 153, 154-155 (1925) (italics supplied). "The bill declares that such agreements *shall be recognized and enforced by the Courts of the United States*." H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924) (italics supplied).

Indeed, this Court has deliberately declined to hold that the Act applies in any respect in the state courts. In *Prima Paint v. Flood & Conklin*, 388 U.S. 395 (1967), a diversity action involving the application of the interstate commerce clause, the Federal Arbitration Act was interpreted to require the arbitrator, not the federal district court, to decide a claim of fraud in the inducement, even in the face of a contrary state rule. The court in *Prima Paint* was asked to hold, based on the reasoning of *Robert Lawrence Co. v. Devonshire Fabrics*, 271 F.2d 402 (2d Cir. 1959), that the Federal Arbitration Act applies in state courts and that it is a national substantive law. The Court refused to do so stating, "the question is whether

Congress may prescribe how *federal courts* are to conduct themselves with respect to subject matter over which Congress plainly has power to legislate. The answer to that can only be in the affirmative." 388 U.S. at 405 (italics supplied).

The Second Circuit itself in *Robert Lawrence Company v. Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959), recognized that, "[t]o be sure much of the Act is purely procedural in character and is intended to be applicable only in the federal courts." 271 F.2d at 407. Hence, in *Main v. Merrill Lynch, Pierce, Fenner & Smith*, 67 Cal.App.3d 19 (1977), the court stated that the Federal Arbitration Act was applicable, yet had no difficulty with the fact that the detailed procedural provisions of the California statute, with respect to notice, hearings, etc., had been applied by the trial court. *See also, Vigo Steamship Corp. v. Marship Corp.*, 26 N.Y.2d 165, 309 N.Y.S.2d 165, *cert. denied*, 400 U.S. 819 (1970) (applying New York law to consolidate arbitration proceedings under Federal Arbitration Act).

By its exaggerated and unsupported interpretation of the scope of the Federal Arbitration Act, Southland seeks to transform issues of local California procedure into far-ranging federal ones. Class arbitration, however, is a procedural issue of concern in this case only to the California courts. It raises no question under the Federal Arbitration Act. A class action is a procedural device, ancillary to the litigation of substantive claims. *Vernon v. Drexel Burnham & Co.*, 52 Cal.App.3d 706, 716 (1975); *Deposit Guaranty National Bank v. Roper*, 445 U.S. 326, 336 (1980). Thus, so long as the forum court has authority based on its own law to employ the class action, there is no impediment to its so doing even when it is applying substantive law of another jurisdiction. *See, Kristiansen v. John Mullins & Sons, Inc.*, 59 F.R.D. 99, 108-110 (E.D.N.Y. 1973); *Briskin v. Glickman*, 267 F.Supp. 600 (S.D.N.Y. 1967).

Where, as here, the substantive claims are based solely on state law, the use of local procedure to enforce those claims is clearly a matter of state, and not federal, concern. California has consistently supported class actions where a widespread practice injures large numbers of people but "the amount of individual recovery would be insufficient to justify bringing an individual action." *Vasquez v. Superior Court*, 4 Cal.3d 800, 808 (1971).[6] It is particularly suited to the special circumstances arising where the contracts are uniform and the same provisions and practices apply to each member of the class. *LaSala v. American Sav. & Loan Assn.*, 5 Cal.3d 864, 877 (1971). The California Supreme Court rightly viewed the question before it as whether, in the context of an arbitration clause contained in an adhesion contract, it had inherent authority to reconcile the competing state policies favoring both arbitration and class actions. It concluded that it did.[7] Thus, the issue was treated as solely one of state procedure, presenting no federal question.

---

[6]These cases are of special importance to state courts since only those class actions where each individual claim exceeds $10,000 are within federal jurisdiction. *Zahn v. International Paper Company*, 414 U.S. 291 (1973). Moreover, since the Federal Arbitration Act does not provide an independent basis for jurisdiction, the court congestion issue raised by Southland is largely a matter of state court dockets.

[7]Southland argues at length that a class action and arbitration are (hypothetically) incompatible. (J.S. 11-15.) This argument is irrelevant here, the question having been determined by the California court as a matter of state law. Indeed, Southland's only direct authority rejecting a class arbitration, *Harris v. Shearson Hayden Stone, Inc.*, 82 A.D.2d 87, 441 N.Y.S.2d 70 (1981), *aff'd mem.*, 56 N.Y.2d 627, 450 N.Y.S.2d 482 (1982), likewise was decided on the basis of state law. The only two other state supreme courts to address this issue directly *approved* class arbitrations under their state laws. *Stevenson v. Com. of Pennsylvania, Dept. of Revenue*, 413 A.2d 667 (Pa. 1980); *Boynton v. Carswell*, 238 Ga. 417, 233 S.E.2d 185 (1977), *overruled on other grounds, Calloway v. Carswell*, 240 Ga. 579, 242 S.E.2d 103 (1978).

The court looked to the federal cases which allow consolidation merely as analogous, and not governing, authority. (J.S.App. 26a-27a.) It also looked to cases from other states which support consolidation of arbitration proceedings, even in the absence of express statutory authority. (J.S.App. at 27a.) It then concluded that the fact that California's arbitration statute contained express authority allowing consolidation did not mean the California Legislature intended to prevent the California courts from ordering class arbitration in an appropriate case. (J.S. App. 28a.)

As is apparent from the foregoing, the question before the California Supreme Court and its resolution of that question were solely a matter of state law. Southland presents no federal question for review by this Court.

**2. The preemption issue does not present a substantial Federal question**

When this case was before the California Supreme Court, preemption was only a back-up argument which Southland did not expect the court to reach. (Reply Brief to Answer to Petition for Hearing, p. 12.) In seeking to compel arbitration, Southland relied primarily on the California arbitration statute. Thus, it argued that the antiwaiver provision of the Franchise Investment Law did not bar arbitration:

> Title 9 of the California Code of Civil Procedure (§ 1280 *et seq.*) establishes a comprehensive arbitration statute, and Section 1281 of that Code declares that written arbitration agreements are "valid, enforceable and irrevocable, save upon such grounds as exist for the revocation of any contract." Arbitration under this statute is highly favored by the law, and the courts have repeatedly held that in cases of doubt, every intendment should be in favor of upholding the agreement to arbitrate. This policy applies to tort claims generally, and to fraud and misrepresentation

> claims in particular. If the California Legislature had intended to overrule this long-standing policy in the case of disputes between franchisors and franchisees, it could and would have done so directly. In the absence of a clear legislative directive, this Court should not overturn the well-established policy by implication. (Reply Brief to Answer to Petition for Hearing, pp. 6-7.)

Southland's argument that the legislature did not intend to bar arbitration was rejected. The Franchise Investment Law is a prepurchase disclosure law modeled after the 1933 Securities Act. (J.S.App. 10a) Section 31512 is virtually identical to section 14 of the Securities Act of 1933, 15 U.S.C. § 77n. The California Supreme Court concluded that the choice of such language evidenced a clear legislative intent that section 31512 be interpreted in accordance with the interpretation given section 14 in *Wilko*.[8] The court's conclusion was buttressed by the legislative history of a different franchise law, the Franchise Relations Act, which explicitly recognized that the earlier law was modeled after the federal securities law and did not permit arbitration. (J.S.App. 11a-13a.) The question whether the court properly interpreted the intent of the California Legislature is purely one of state law and beyond the scope of review by this Court. *Merrill Lynch, Pierce, Fenner &*

---

[8]The California court applied its own long recognized principle that state statutes patterned after federal statutes were intended to have a like interpretation. (J.S.App. 11a.) California is not alone in interpreting language similar or identical to the antiwaiver provisions of section 14 of the Securities Act, 15 U.S.C. § 77n, as precluding arbitration. *See, e.g., State Ex. Rel. Geil v. Corcoran*, 623 S.W.2d 557 (Mo. App. 1981) (state securities law precludes enforcement of arbitration clause); *Sandefer v. Reynolds Securities Inc.*, 618 P.2d 690 (Colo. App. 1980) (same); *Kiehne v. Purdy*, ... Minn. ..., 309 N.W.2d 60 (1981) (same).

*Smith v. Ware*, 414 U.S. 117, 133 (1973), *General Trading Co. v. State Tax Comm.*, 322 U.S. 335, 337 (1944).[9]

After reaching this conclusion, the California court was faced with the issue of possible preemption by the Federal Arbitration Act. As discussed above, the application of the Federal Arbitration Act in state court has never been mandated by Congress or this Court. Nonethless, the California Supreme Court, as well as a majority of state courts which have considered the question, recognizes that "the statute contains certain principles of 'substantive federal law' which must be applied regardless of forum, where federal jurisdiction exists." (J.S. App. 14a.)[10]

---

[9]Southland makes much of the fact that the State of Washington in *Allison v. Medicab International, Inc.*, 92 Wash.2d 199, 597 P.2d 380 (1979), has interpreted its own franchise investment law differently, but that is of no import in determining the intent of the California Legislature. Indeed, in *Allison* the Washington court appears to have mistakenly discussed *Wilko* in terms of its impact on preemption, not as an aid in interpreting the intent of the Washington Legislature in passing that state's franchising statutes. 92 Wash. 2d at . . , 597 P.2d at 382. In neither *Allison*, nor the case upon which it relied—*Pinkis v. Network Cinema Corporation*, 9 Wash. App. 337, 512 P.2d 751 (1973)—was there a discussion of the policies and purposes behind the federal arbitration law or the Washington franchising statutes.

[10]Indeed, in *Barron v. Tastee Freez Intern., Inc.*, 482 F.Supp. 1213 (E.D. Wisc. 1980) and *Bache Halsey Stuart Shields, Inc. v. Moebius*, 531 F.Supp. 75 (E.D. Wisc. 1982), two cases relied upon by Southland, the district courts assumed that the Federal Arbitration Act applied only to federal courts. Both courts stated that in adjudicating the enforceability of an arbitration clause in a diversity action, a federal court was not required to consider any contrary state policy and might well reach a different result than a state court faced with the same issue. 482 F.Supp. at 1217, 531 F.Supp. at 77. *But see Muh v. Newburger, Loeb & Co.*, 540 F.2d 970 (9th Cir. 1976), where the court assumed that the state exception applied with equal force in federal court.

The California Supreme Court thus determined that the franchise agreements were within the broad reach of the Commerce Clause and therefore governed by the substantive provisions of the Federal Arbitration Act. Contrary to Southland's position, this does not end any inquiry as to the enforceability of the instant arbitration clauses. It begins the inquiry.

The first question is the scope of the Federal Arbitration Act under federal law. This Court itself has noted that "categories of contracts otherwise within the Arbitration Act but in which one of the parties characteristically has little bargaining power are expressly excluded [under 9 U.S.C. § 1] from the reach of the Act." *Prima Paint Corp. v. Flood & Conklin*, 388 U.S. 395, 402 n. 9 (1967). This Court has also recognized the inapplicability of the Federal Arbitration Act to other categories of disputes where the congressional schemes require judicial supervision to protect individuals from falling victim to the other party's superior bargaining power. *Wilko v. Swan*, 346 U.S. 427 (1953). Similarly, the circuit courts have held that claims under the Securities Exchange Act of 1934,[11] and the federal antitrust and bankruptcy laws are not arbitrable because the nature of the statutory schemes and the vital public interest involved necessitate judicial scrutiny.[12]

---

[11] *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974) is not authority to the contrary. It has been uniformly interpreted to create a narrow exception to *Wilko* due to overriding policy considerations in the area of international securities transactions negotiated between parties of relatively equal bargaining power. *Accord, Mansbach v. Prescott Ball & Turben*, 598 F.2d 1017 (6th Cir. 1979); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith*, 558 F.2d 831 (7th Cir. 1977); *Sibley v. Tandy Corp.*, 543 F.2d 540 (5th Cir. 1976); *Ayres v. Merrill Lynch, Pierce, Fenner & Smith*, 538 F.2d 532 (3d Cir. 1976).

[12] *See, e.g., Merrill Lynch, Pierce, Fenner & Smith v. Moore*, 590 F.2d 823 (10th Cir. 1978); *Allegaert v. Perot*, 548 F.2d 432 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977); *American Safety Equipment Corp. v. J. P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968);

In interpreting their own state statutory schemes, the state courts have followed the lead of the federal courts and carved exceptions to the enforceability of arbitration clauses when necessary to effectuate other vital state policies.[13] In most cases, no conflict exists between the modern state arbitration laws and the Federal Arbitration Act. When a question does arise regarding a possible conflict between the application of the Federal Arbitration Act and the state arbitration laws, state courts have engaged in a responsible weighing process which balances the state's interest in enforcing its policy against the federal policy.[14] Thus, in *R.J. Palmer Construction Co. v.*

---

*accord, A. & E. Plastik Pak Co. v. Monsanto Company*, 396 F.2d 710 (9th Cir. 1968); *Lee v. Ply Gem Industries, Inc.*, 593 F.2d 1266 (D.C. Cir.), *cert. denied*, 441 U.S. 967 (1979); *Applied Digital Technology, Inc. v. Continental Casualty Co.*, 576 F.2d 116 (7th Cir. 1978). Until recently, courts had also interpreted the patent and trademark laws as requiring judicial enforcement—a practice which was consistent with prior law but which has now been superseded by congressional directive in enacting the patent and trademark appropriations bill for 1983-85 Pub. L. No. 97-247 (1982). Significantly, Congress has left untouched the judicial construction of its intent in the area of securities litigation, bankruptcy and antitrust.

[13]*See, e.g., Kiehne v. Purdy*, . . . Minn. . . , 309 N.W.2d 60 (1981) (state securities law claims not arbitrable), *Sandefer v. Reynolds Securities Inc.*, 618 P.2d 690 (Colo. App. 1980) (same); *United Nuclear Corp. v. General Atomic Co.*, 93 N.M. 105, 597 P.2d 290, *cert. denied*, 444 U.S. 911 (1979) (state antitrust law claim not arbitrable), *Aimcee Wholesale Corp., v. Tomar Products Inc.*, 21 N.Y.2d 621, 237 N.E.2d 223 (1968) (same); *Durst v. Abrash*, 22 A.D.2d 39, 253 N.Y.S.2d 351 (1964) (issue of whether transaction was disguised usurious loan not arbitrable).

[14]As of January 1, 1982, 42 states and the District of Columbia have adopted modern arbitration statutes, *i.e.*, statutes enforcing agreements to arbitrate existing controversies *and* those arising in the future. Twenty-five states and the District of Columbia have adopted the Uniform Arbitration Act although a number of them have modified the Act to exclude certain categories of disputes. Variations include statutory exclusions as to *employer-employee disputes, e.g.*, Tex. Rev. Civ. Stat. Ann. art. 224 (Vernon Supp.

*Wichita Band Instrument Co.*, 7 Kan.App. 363, 642 P.2d 127 (1982), the state court held that its statutory policy against arbitration of any tort claim was outweighed by the federal policy in favor of arbitration.[15] In *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Melamed*, 405 So. 2d 790 (Fla. [Dist. Ct. App.] 1981), the state appellate court upheld a New York arbitration provision in a contract on the ground that the Federal Arbitration Act prevailed over a state statute generally outlawing out-of-state arbitration provisions.

Narrowly drawn categories of exemption from arbitration require closer analysis of the legislative intent and the preemption question. In *Allison v. Medicab International, Inc.*, 92 Wash.2d 199, 597 P.2d 380 (1979), cited by Southland, the court found insufficient evidence of a legislative intent to bar arbitration under Washington's franchising law. It used the possibility of preemption as a further reason to infer that the legislature did not intend to bar arbitration.[16] Southland mistakenly relies on this decision

---

1981); *torts, e.g.*, Ark. Stat. Ann. § 34-511 (Bobbs-Merrill Supp. 1981); *uninsured motorists, doctors* and *lawyers, e.g.*, S.C. Code § 15-48-10 (Lawyer Co-op Supp. 1981); and *contracts of adhesion, e.g.*, Iowa Code Ann. § 697A.1 (West Supp. 1982).

[15]Southland's hypothesis (J.S. 26) that if franchisor-franchisee disputes are not arbitrable under California law, the arbitration of interstate tort claims would soon be banned, is erroneous. As Southland is aware, California law is consistent with federal law in considering tort claims arbitrable. Kansas appears to be the only state to face the issue posed by Southland and has given overriding force to the Federal Arbitration Act.

[16]In *Middle East Transcontinental, Inc. v. Onion Crock, Inc.*, 144 Mich.App. 57, 318 N.W.2d 604 (1982), the court likewise found no legislative intent to reserve franchise claims for the judicial forum and did not reach the issue of preemption. In attempting to analyze the *Wilko* decision, the court relied on the wider choice of venue in federal court as the governing rationale. Southland does likewise. (J.S. 22 n. 34.) The *Wilko* decision, however, is not so limited. *See* discussion in *Wilko v. Swan*, 346 U.S. 427, 435-438 (1953); *see also Bernhardt v. Polygraphic Co.*, 350 U.S. 198, 202-203 (1956).

as evincing a belief that the Federal Arbitration Act is national substantive law preventing state law exceptions to arbitration. This is not true. Where a Washington appellate court did find a strong anti-arbitration policy in its Consumer Protection Act, the court proceeded to uphold such legislation in the face of a claim that it was preempted by the Federal Arbitration Act. *Wineland v. Marketex Intern. Inc.*, 28 Wash.App. 830, 627 P.2d 967 (1981).

> Considering the purpose of the Consumer Protection Act, its close similarity to the federal antitrust laws, and the clear exception to the operation of the arbitration act covering antitrust laws, we conclude that the policy of the arbitration act favoring arbitration should give way to the stronger policy behind the Consumer Protection Act. 28 Wash.App. at ....., 627 P.2d at 970, distinguishing *Allison v. Medicab International, Inc.*, 92 Wash.2d 199, 597 P.2d 380.

The Missouri Court of Appeals has likewise refused to order arbitration requested under both federal and state arbitration acts where violations of state securities law were alleged because of Missouri's "very strong policy in favor of providing a judicial forum for the claims of investors under the blue sky laws." *State Ex. Rel. Geil v. Corcoran*, 623 S.W.2d 557, 559 (Mo.App. 1981).

The California Supreme Court undertook a similar balancing test in reaching its conclusion that the Franchise Investment Law was not preempted by the Federal Arbitration Act. A close analysis of the preemption issue demonstrates the correctness of the court's decision.

**"[W]hen a State's exercise of police power is challenged under the Supremacy Clause, '[this court] start[s] with the assumption that the historic police powers of the States [are] not to be superseded by [federal statutes] unless that was the *clear and manifest* purpose of Con-**

gress.' [Citations.]" *Ray v. Atlantic Richfield Co.*, 435 U.S. 151, 157 (1978) (italics supplied).

As this Court has noted in an analogous context:

> "[F]ederal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained." . . . [B]ecause "each case turns on the peculiarities and special features of the federal regulatory scheme in question," it is where there is in existence a pervasive and comprehensive scheme of federal regulation that pre-emption follows. *Merrill Lynch, Pierce, Fenner & Smith v. Ware*, 414 U.S. 117, 139 (1973.)

*See also, Fidelity Federal Savings & Loan Assn. v. de la Cuesta*, ..... U.S. ....., 102 S.Ct. 3014 (1982).

In *American Airlines, Inc. v. Louisville & Jefferson C.A.B.*, 269 F.2d 811 (6th Cir. 1959), the Sixth Circuit analyzed the precise preemption issue involved here in holding that the district court properly looked to the law of Kentucky in finding that it was beyond the authority of the Air Board to enter into an arbitration agreement. The court succinctly stated the issue as follows:

> Federal power to pre-empt being clear, it remains to inquire just how much of the field the Congress intended to and did occupy [citation omitted]. Section 2 of the Federal arbitration statute, as qualified by § 1, determines the particular controversies to which §§ 3 and 4 of the statute may be applicable. [Citations.]
>
> • • •
>
> While the language [of § 2] might plausibly be read to support a broader construction, consideration of the Legislative history reveals that what the Congress intended was merely to overrule by legislation long-standing judicial precedent, which declared agree-

> ments to submit judicable controversies to arbitration contrary to public policy, on the ground that enforcement of such agreement would oust the courts of their jurisdiction . . . .
>
> [T]he Federal arbitration statute was intended to declare no more than the agreements to arbitrate "involving commerce," [9 U.S.C. §§ 1 and 2] previously held invalid or revocable or unenforceable for policy reasons apposite to arbitration in particular, such as ousting the courts of jurisdiction, are by virtue of the [Act] valid and enforceable, unless by other Federal law or State law such agreements are for other reasons to be held invalid or revocable or unenforceable. *American Airlines, Inc. v. Louisville & Jefferson C.A.B.*, 269 F.2d 811, 816 (6th Cir. 1959)[17]

The California court correctly recognized that the Federal Arbitration Act does not supplant all state law regarding the enforcement of arbitration clauses. It then analyzed the policies advanced by Corporations Code section 31512 to determine whether they were irreconcilable with the federal law. For this purpose, the California court looked to this Court's opinion in *Merrill Lynch, Pierce, Fenner & Smith v. Ware*, 414 U.S. 117 (1973). In *Ware*, a class action for collection of trust fund benefits, this Court considered an alleged conflict between arbitration mandated by the New York Stock Exchange rules adopted under the self-governing provisions of section 6 of the Securities Exchange Act, 15 U.S.C. § 78f, and California Labor Code section 229 (invalidating any private agreement to arbitrate a wage dispute). The unanimous opinion concluded that the exchange rules did not preempt the state Labor

---

[17]*See also Duplan Corp. etc. v. W.B. Davis Hosiery Mills*, 442 F.Supp. 86 (S.D.N.Y. 1977) and *Supak & Sons Mfg. Co. v. Pervel Industries, Inc.*, 593 F.2d 135 (4th Cir. 1979), which both concluded that state laws incorporating U.C.C. § 2-207(2)(b) were not preempted by the Federal Arbitration Act.

Code because California "manifested a strong policy of protecting its wage earners from what it regards as undesirable economic pressures affecting the employment relationship." 414 U.S. at 140 (Stewart, J., not participating).

In its brief, Merrill Lynch relied on *Robert Lawrence,* discussed *supra* at p. 11, in arguing that the Federal Arbitration Act applied to its dispute with the alleged class represented by Ware. Nonetheless, the effect of the Federal Arbitration Act was not discussed in the *Ware* opinion. Southland asserts that a likely reason is that *Ware* involved a contract of employment exempted from arbitration under section 1 of the Act. (J.S. 25 n. 35.) Although that argument was made to the *Ware* court, it had no support in the case law. Federal courts facing the issue had long since held that account executives, such as Ware, were not "employees" within the meaning of section 1; and that the exception was limited to employees engaged in the *actual* movement of interstate goods. *Dickstein v. DuPont,* 443 F.2d 783, 785 (1st Cir. 1971); *Tenney Engineering, Inc. v. United Electrical Radio & Machine Workers,* 207 F.2d 450, 452-453 (3d Cir. 1953). It is doubtful that the *Ware* court would have overruled such cases *sub silentio,* and it has never been so interpreted. *See, e.g., Stokes v. Merrill Lynch, Pierce, Fenner & Smith,* 523 F.2d 433, 436 (6th Cir. 1975). Rather, the federal courts continue to include account executives within the ambit of the Federal Arbitration Act. 523 F.2d at 436; *Muh v. Newburger, Loeb & Co.,* 540 F.2d 970 (9th Cir. 1976).

Thus, Southland's attempt to distinguish *Ware* from the case at bar is in error. Subsequent case law suggests two other explanations for the *Ware* opinion's silence as to the impact of the Federal Arbitration Act—as an indication that the Act did not apply in state court[18] or that appli-

---

[18] *See Stokes v. Merrill Lynch, Pierce, Fenner & Smith,* 523 F.2d 433, 436 (6th Cir. 1975).

cation of the Federal Arbitration Act does not affect the preemption analysis.[19] The California Supreme Court's decision reflects the latter view.

The *Ware* court gave effect to California's strong concern for the protection of wage earners. In the case at bar, California has manifested another strong concern: the protection of investors in franchise operations from misrepresentations by franchisors. California has determined that franchise investors, as a class, are in need of the same protection as that provided by Congress to investors in securities markets "requir[ing] the exercise of judicial direction to fairly assure [the] effectiveness" of the legislation. *Wilko v. Swan, supra,* 346 U.S. 427 at 437.

In this situation, as in *Ware,* there is no persuasive reason why the federal policy favoring arbitration should be deemed to preempt section 31512. The interpretation of the Act urged by Southland in this case will leave states powerless to enforce laws modeled after the federal antitrust and securities laws whenever arbitration clauses are inserted by the party with superior bargaining power.[20] The Federal Arbitration Act does not apply to similar federal claims. It would be anomalous indeed if it were interpreted absolutely to prohibit parallel state legislation:

---

[19]*See Muh v. Newburger, Loeb & Co.,* 540 F.2d 970, 973 (9th Cir. 1976), where the court assumed the *Ware* preemption analysis applied in a similar case governed by the Federal Arbitration Act, but ruled that Labor Code section 229 was unavailable as a bar because the plaintiff did not have a true wage claim.

[20]Southland's argument that the state laws could still validly bar arbitration in intrastate disputes is practically meaningless. The broad scope presently given the commerce clause, together with the reality of today's business operations renders almost all entrepreneurs participants in interstate commerce. The "Mom and Pop" grocers who comprise the plaintiffs in this action are but one example. It is hard to imagine any franchise subject to the California Franchise Investment Law that would not have some involvement in interstate commerce.

"When respective federal and state sovereignties are juxtaposed, 'the proper approach is to reconcile "the operation of both statutory schemes with one another rather than holding one completely ousted."'" *Merrill Lynch, Pierce, Fenner & Smith v. Ware*, 414 U.S. 117, 127 (1973). Since the California statutory scheme is compatible with the federal scheme, this case presents no question for review before this Court.

## CONCLUSION

The procedural history of this case, and in fact many of the arguments advanced before this Court, demonstrate that Southland's true intent is not to preserve the asserted inviolability of arbitration but to escape responsibility for its acts. In seeking arbitration, Southland relied on the parallel provisions of the California arbitration statute and the Federal Arbitration Act. It considered the California statute to govern both the procedural issue of class arbitration and the Franchise Investment Law claim. It relied on the federal act only as a back-up on the latter issue. Not until after the California Supreme Court ruled that Southland could not thwart a class by mere invocation of its arbitration clause did Southland abandon its reliance on the California statute.

Southland's posturing notwithstanding, there are no substantial federal questions here. The California Supreme Court's determination as to how this action should proceed is a matter of state concern presenting no issue for review by this Court. Accordingly, appellees respectfully submit that Southland's appeal be dismissed and its alternative petition for certiorari be denied.

Respectfully submitted,

JOHN F. WELLS
*Attorney for Appellee*

STARK, STEWART, WELLS & ROBINSON
BROWN & FINNEY
*Of Counsel.*

November 23, 1982.